

THE HONORABLE JOHN C. COUGHENOUR

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

JAMES HAMMER, On Behalf of Himself
and All Others Similarly Situated,

Plaintiff,

v.

FRONTIER FINANCIAL
CORPORATION, PATRICK M. FAHEY,
JOHN J. DICKSON, MICHAEL J.
CLEMENTZ, CAROL E. WHEELER, and
ROB ROBINSON,

Defendants.

Case No. 10-0643-JCC

**CONSOLIDATED CLASS ACTION
COMPLAINT FOR VIOLATIONS OF
THE FEDERAL SECURITIES LAWS**

JURY TRIAL DEMANDED

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1 3. The Bank had dozens of branches in Washington and Oregon. Historically, it
 2 focused on loans related to real estate, which included loans for construction, land
 3 development, completed lots, and residential single family homes. Defendants participated in a
 4 scheme to defraud investors by concealing the Bank's unsafe lending practices and making
 5 false statements regarding, *inter alia*: (i) Frontier's lending and credit risk practices; (ii) the
 6 quality of its loan portfolio; (iii) Frontier's financial disclosures, including revenues, earnings,
 7 assets, capital position, and overall financial condition, as well as the accounting for its
 8 Allowance for Loan and Lease Losses ("ALLL"); (iv) compliance with regulatory
 9 requirements and guidance; and (v) the impact of the real estate and credit crises on Frontier.

10 4. Frontier reported false and misleading financial results for Q2 2008 through the
 11 2008 fiscal year by failing to properly account for loan loss reserves. Loan loss reserves are
 12 reflected in the balance sheet (as an asset) and the income statement (as a direct reduction of
 13 pre-tax earnings). Thus, by under-reserving for loan losses, the Defendants were able to
 14 overstate Frontier's assets and net income. Based on the Bank's stake in risky and impaired
 15 real estate loans, the Company should have increased the ALLL and loan loss provision.
 16 Frontier's demise was caused by its reckless lending practices, failure to maintain adequate
 17 capital, and failure to record adequate loan losses. Ultimately, it was this risk that forced
 18 federal regulators to take over the Bank's operations.

19 5. In July 2008, the FDIC and DFI conducted a joint examination of the Bank. No
 20 later than August 8, 2008, Defendants were expressly told that the Bank was operating with
 21 inadequate capital. This is confirmed by Confidential Witness No. 5 ("CW5"),² who was an
 22 internal auditor that reported directly to the Audit Committee of the Board of Directors. CW5
 23 attended a meeting that included the regulators, the entire Board of Directors (either in-person
 24 or by conference call), and all members of senior management, including each of the
 25 Individual Defendants. CW5 reported that the meeting "did not go well for the company" and
 26

27 ² References to "CW__" are to Confidential Witnesses interviewed in connection with Lead
 28 Plaintiff's investigation.

1 that “one had to know that a C&D [cease and desist order] was going to be forthcoming.” The
 2 DFI and FDIC had identified numerous unsafe and unsound banking practices at the Bank,
 3 including:

4 (a) operating with management whose policies and practices were
 5 detrimental to the Bank and jeopardized the safety of deposits;

6 (b) operating with a Board of Directors that failed to provide adequate
 7 supervision over, and direction to, management of the Bank;

8 (c) operating with inadequate capital given the kind and quality of the
 9 Bank’s assets;

10 (d) operating with an inadequate loan valuation reserve;

11 (e) operating with a large number of poor quality loans;

12 (f) engaging in unsatisfactory lending and collection practices;

13 (g) operating in a manner that produced low earnings;

14 (h) operating with inadequate provisions for liquidity.

15 6. Defendants made no public disclosure of this information and, instead, assured
 16 investors that Frontier was adequately capitalized. Defendants’ concealment of these material
 17 facts misled investors and caused Frontier’s shares to trade at artificially inflated levels during
 18 the Class Period. Once the truth became known to investors, the stock purchased during the
 19 Class Period by Lead Plaintiff and the Class members lost virtually all value and was delisted
 20 from the NASDAQ stock market.

21 **JURISDICTION AND VENUE**

22 7. The claims asserted herein arise under and are brought pursuant to Sections
 23 10(b) and 20(a) of the Securities Exchange Act of 1934 (the “Exchange Act”), 15 U.S.C.
 24 §§78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder by the SEC, 17 C.F.R. §240.10b-
 25 5.

26 8. This Court has jurisdiction over the subject matter of this action pursuant to
 27 28 U.S.C. §§1331 and 1337, and Section 27 of the Exchange Act, 15 U.S.C. §78aa.

1 31, 2008, filed March 12, 2009. Dickson also signed certifications pursuant to Sections 302
2 and 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. §1350, contained in the foregoing
3 quarterly reports only, issued by Frontier during the Class Period, which attested to the
4 adequacy of the Company's internal controls and accounting systems.

5 14. Defendant Patrick M. Fahey ("Fahey") was, after December 8, 2008, Chief
6 Executive Officer ("CEO") of Frontier and Chairman of the Board of Directors of Frontier and
7 the Bank. He had served as director for Frontier and the Bank since 2006. While on the
8 Frontier board, Mr. Fahey served on its audit committee until he became Chairman of the
9 Board. During the Class Period, Fahey signed Frontier's Form 10-K for the year ended
10 December 31, 2008, filed March 12, 2009 and certifications pursuant to Sections 302 and 906
11 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. §1350, contained therein, which attested to the
12 adequacy of the Company's internal controls and accounting systems. Fahey previously served
13 as Chairman of Regional Banking at Wells Fargo Bank. Prior to that, Fahey was Founder,
14 President and CEO of Pacific Northwest Bank for 16 years.

15 15. Defendant Michael J. Clementz ("Clementz") was, after December 8, 2008,
16 President of Frontier, CEO of the Bank, and Director of both Frontier and the Bank. He served
17 in those capacities until his retirement on December 31, 2009. Clementz had previously served
18 as President and CEO of Frontier for three years. Clementz was first appointed to the Boards
19 of Frontier and the Bank in 2000. During the Class Period, Clementz signed Frontier's Form
20 10-K for the year ended December 31, 2008, filed March 12, 2009.

21 16. Defendant Carol E. Wheeler ("Wheeler") was at all relevant times, Chief
22 Financial Officer ("CFO"), Principal Accounting Officer and Secretary of Frontier. During the
23 Class Period, Wheeler signed the following Frontier SEC filings: (i) Frontier's Form 10-Q for
24 the second quarter of the fiscal year 2008, filed August 1, 2008; (ii) Frontier's Form 10-Q for
25 the third quarter of the fiscal year 2008, filed October 31, 2008; and (iii) Frontier's Form 10-K
26 for the year ended December 31, 2008, filed March 12, 2009. Wheeler also signed
27 certifications pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C.
28 §1350, contained in the foregoing quarterly reports and Form 10-K issued by Frontier during

1 the Class Period, which attested to the adequacy of the Company's internal controls and
2 accounting systems. Wheeler was responsible during the Class Period for the oversight of
3 Frontier's financial reporting and management.

4 17. Defendant Rob Robinson ("Robinson") was at all relevant times, the Bank's
5 Chief Credit Officer.

6 18. During the Class Period, defendants, as senior executive officers and/or
7 directors of Frontier, were privy to confidential and proprietary information concerning
8 Frontier, its operations, finances, financial condition and present and future business prospects.
9 Defendants also had access to material adverse non-public information concerning Frontier, as
10 alleged below. Because of their positions with Frontier, defendants had access to non-public
11 information about the Company's business, finances, products, markets and present and future
12 business prospects via access to internal corporate documents, conversations and connections
13 with other corporate officers and employees, attendance at management and/or board of
14 directors meetings and committees thereof and via reports and other information provided to
15 them in connection therewith. Defendants knew or recklessly disregarded that the adverse
16 facts specified herein had not been disclosed to, and were being concealed from, the investing
17 public.

18 19. Defendants are liable as direct participants in the wrongs complained of herein.
19 In addition, defendants, by reason of their status as senior executive officers and/or directors,
20 were "controlling persons" of Frontier within the meaning of §20(a) of the Exchange Act and
21 had the power and influence to cause the Company to engage in the unlawful conduct
22 complained of herein. Because of their positions of control, defendants were able to and did,
23 directly or indirectly, control the conduct of Frontier's business.

24 20. Defendants participated in the preparation of, and controlled and/or possessed
25 the authority to control the content of, the Company's reports, releases and presentations to
26 securities analysts and through them, to the investing public. Defendants were provided with
27 copies of the Company's reports and releases alleged herein to be misleading prior to or shortly
28 after their issuance, and had the ability and opportunity to prevent their issuance or cause them

1 to be corrected. Thus, defendants had the opportunity to commit the fraudulent acts alleged
2 herein.

3 21. As senior executive officers and/or directors and as controlling persons of a
4 publicly traded company whose common stock was registered with the SEC pursuant to the
5 Exchange Act, and was traded on the NASDAQ National Market System and governed by the
6 federal securities laws, defendants had a duty to promptly disseminate accurate and truthful
7 information with respect to Frontier's financial condition and performance, growth, operations,
8 financial statements, business, products, markets, management, earnings and present and future
9 business prospects, and to correct any previously issued statements that had become materially
10 misleading or untrue, so that the market price of Frontier's common stock would be based
11 upon truthful and accurate information. Defendants' misrepresentations and omissions during
12 the Class Period violated these specific requirements and obligations.

13 22. Defendants are liable as participants in a fraudulent scheme and course of
14 conduct, which operated as a fraud or deceit on purchasers of Frontier's common stock, by
15 disseminating false and misleading statements and/or concealing material adverse facts. The
16 scheme: (i) deceived the investing public regarding Frontier's business, operations,
17 management and the intrinsic value of Frontier's securities; and (ii) caused Lead Plaintiff and
18 members of the Class to purchase Frontier's common stock at artificially inflated prices.

19 **CLASS ACTION ALLEGATIONS**

20 23. Lead Plaintiff brings this action as a class action pursuant to Rule 23(a) and
21 23(b)(3) of the Federal Rules of Civil Procedure on behalf of himself and all persons who
22 purchased or otherwise acquired Frontier common stock during the Class Period. Excluded
23 from the Class are Defendants and their families, the officers and directors of the Company at
24 all relevant times, members of their immediate families and their legal representatives, heirs,
25 successors or assigns and any entity in which Defendants have or had a controlling interest.

26 24. The members of the Class are so numerous that joinder of all members is
27 impracticable. While the exact number of Class members can only be ascertained through
28 appropriate discovery, Lead Plaintiff believes that there are hundreds if not thousands of

members in the proposed Class who are geographically dispersed. Frontier had the equivalent of 47,000,000 shares of stock outstanding during the Class Period.

25. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting only individual Class members. Among the questions of law and fact common to the Class are the following:

- (a) Whether the Defendants violated the federal securities laws through their acts and/or omissions as alleged herein;
- (b) Whether Defendants directly or indirectly participated in and pursued the fraudulent plan and scheme and common course of conduct as alleged herein;
- (c) Whether the filings, reports, documents, statements, and attestations made by Defendants during the Class Period omitted or misrepresented material facts about the business, operations, performance, and/or financial condition of Frontier;
- (d) Whether the public statements issued by Frontier and the individually named Defendants, including Frontier's financial statements and filings with the SEC, contained material misrepresentations and/or omitted to state material facts;
- (e) Whether the Defendants acted knowingly or with reckless disregard for the truth in misrepresenting and omitting material facts in committing the wrongful acts complained of herein;
- (f) Whether the market price of Frontier common stock during the Class Period was manipulated or artificially inflated due to the misrepresentations and/or omissions complained of herein; and
- (g) Whether Lead Plaintiff and other members of the Class have sustained damages and, if so, the proper measure of such damages.

26. Throughout the Class Period, and until May 12, 2010, Frontier common stock met the requirements to be listed on the NASDAQ stock market, an efficient market, under the

1 symbol “FTBK.” As a regulated issuer, Frontier filed periodic public reports with the SEC that
 2 included Frontier’s financial statements and other material information. Many of false and
 3 misleading statements alleged herein were made in Frontier’s SEC filings and related
 4 disclosures, and caused Frontier stock to trade at artificially inflated prices during the Class
 5 Period. Frontier’s management regularly met with, and provided information to, securities
 6 analysts, institutional investors, and other market professionals.

7 27. Lead Plaintiff’s claims are typical of the claims of the Class as all members of
 8 the Class were similarly affected by Defendants’ wrongful conduct in violation of the federal
 9 securities laws as alleged herein. Lead Plaintiff and all members of the Class acquired Frontier
 10 stock during the Class Period and have sustained damages arising out of Defendants’ wrongful
 11 conduct as alleged herein upon the full disclosure of the wrongdoing.

12 28. Lead Plaintiff will zealously prosecute the claims, will fairly and adequately
 13 protect the interests of the members of the Class, and has retained counsel competent and
 14 experienced in securities litigation and class actions. Lead Plaintiff does not have any interests
 15 antagonistic to or in conflict with the other members of the Class.

16 29. A class action is superior to all other available methods for the fair and efficient
 17 adjudication of this controversy since joinder of all Class members is impracticable.
 18 Furthermore, as the damages suffered by individual Class members may be relatively small,
 19 the expense and burden of individual litigation make it impossible for members of the Class to
 20 individually redress the wrongs complained of herein. There will be no difficulty in the
 21 management of this action as a class action.

22 **OVERVIEW OF THE FRAUD**

23 30. Prior to and throughout the Class Period, the Defendants sought to mask the
 24 Bank’s financial problems and failure to comply with regulatory standards. In May or June of
 25 2008, CW6 conducted an annual loan loss reserve audit.³ The initial loss number was decided
 26

27 ³ CW6 was a Senior Internal Auditor at the Bank from 2005 through the end of the Class
 28 Period. CW6 reported to the Vice President, Internal Audit.

1 upon by Defendants Robinson, Dickson, and Wheeler, and then the numbers were confirmed
 2 by Lewis Hendry, a financial analyst who reported to Robinson. CW6 reviewed Hendry's
 3 workpapers, confirmed the calculations, and checked how Hendry had analyzed the data in
 4 support of the loan loss reserve. CW6 saw that the loan loss reserve was based on annual
 5 appraisals conducted before 2008. Given the rapidly changing market conditions, the
 6 appraisals were outdated and gave inflated valuations for the underlying properties. Using the
 7 outdated real estate valuations artificially diminished the losses on loans secured by the
 8 properties, which made the loan loss reserve numbers generated in 2008 unreliable.

9 31. CW11 also confirmed that Defendants Dickson, Fahey, Wheeler, and Robinson
 10 were directly involved in determining the loss reserve and were members of the Asset Liability
 11 Committee ("ALCO").⁴ According to CW11, ALCO met "late in the first week" of each
 12 month to review the prior month's data, including the loan loss allowance or reserve, deposits,
 13 expenses. After each quarter, ALCO reviewed the income and balance sheet before the
 14 preliminary financial results were publicly disclosed.

15 32. In mid-June 2008, Frontier was informed that DFI and the FDIC were planning
 16 an on-site examination to review the Bank's operations, according to CW2. CW2 indicated
 17 that, six weeks before the examination, the Bank's management was sent a letter regarding the
 18 records the Bank was required to make available.⁵ CW1 confirmed that the on-site
 19 examination did, in fact, occur from July 21, 2008 through August 8, 2008.⁶ Eleven examiners
 20 were involved, led by an Examiner-in-Charge ("EIC"). The regulators interviewed the Bank's
 21 CEO (defendant Dickson), President (defendant Clementz), CFO (defendant Wheeler), as well
 22 as the Controller, Chief Credit Officer, loan officers, credit officers, and internal auditors.

23
 24
 25
 26 ⁴ CW11 was hired by the Bank in June 2007 and served as Senior Vice President, Operations.

27 ⁵ CW2 is a DFI official with personal knowledge of the Frontier examination.

28 ⁶ CW1 is an executive assistant in the Banking Division at DFI.

1 33. CW8 was one of the Bank employees responsible for compiling the documents
2 and other information requested by the examiners.⁷ CW8 stated that, near the end of the
3 examination, “exit agendas” were shared by the examiners with management, including
4 defendants Dickson, Wheeler, Fahey, and Robinson, who had been told of the results of the
5 examination.⁸

6 34. CW5, the internal auditor who reported to the Board’s Audit Committee,
7 attended a meeting in early August 2008 at which the Defendants were told the findings of the
8 regulatory examination. The meeting was attended by Frontier’s entire Board of Directors, and
9 all members of senior management. The regulators informed the Bank of certain “CAMELS”
10 ratings it had received. CAMELS ratings are based on a scale of 1 to 5 (with 5 as the lowest
11 score) based on a Bank’s Capital, Asset quality, Management, Earnings, Liquidity, and
12 Sensitivity to risk. When the CAMELS ratings were presented at the meeting, it was apparent
13 to CW5 that a cease and desist order was forthcoming.⁹ Following this meeting, Defendants
14 clearly knew that the Bank was:

15 (a) operating with management whose policies and practices were
16 detrimental to the Bank and jeopardized the safety of deposits;

17 (b) operating with a Board of Directors that failed to provide adequate
18 supervision over, and direction to, management of the Bank;

19 (c) operating with inadequate capital given the kind and quality of the
20 Bank’s assets;

21 (d) operating with an inadequate loan valuation reserve;

22 (e) operating with a large number of poor quality loans;

23
24 ⁷ CW8 was an Assistant Vice President, Audit Project Manager who worked at the Bank from
25 2004 through April 2009.

26 ⁸ CW10 who was a Fraud and Risk Manager hired in 2005. In July 2008, her work required
27 interaction the Bank’s loan group. CW10 learned of the regulators’ presence and was told by
28 loan employees that “things don’t look too good now for the bank” because the examiners were
investigating an issue previously unknown to them.

⁹ CW5 left Frontier in Q3 2009 because he “saw the hand writing on the wall for Frontier...”

- (f) engaging in unsatisfactory lending and collection practices;
- (g) operating in a manner that produced low earnings;
- (h) operating with inadequate provisions for liquidity.

35. On December 8 or 9, 2008, CW9 was called to a meeting with defendants Dickson and Clementz and offered a new job as Credit Administrator.¹⁰ CW9 was told that Defendant Fahey had met with the FDIC, which demanded that the Bank replace its senior management based on the July 2008 examination. Thus, defendants Fahey and Clementz moved from Board of Directors positions to operating positions. Defendant Dickson resigned his positions as CEO and Chairman of Frontier and the Bank. Defendant Fahey became Chairman and CEO of Frontier and Chairman of the Bank. Defendant Clementz became President and CEO of the Bank.

36. Then, one or two days before Christmas in 2008, defendant Fahey called CW12 into his office. CW12 was the Executive Vice President, Cashier during the Class Period. Defendant Fahey told CW12 to immediately obtain \$100 million to \$200 million in broker deposits.¹¹ CW12 told Defendant Fahey that it could not be done until the following Monday at the earliest due to the holiday, which caused Fahey to become very agitated. CW12 stated, “The clear sense that I got from Fahey as to his agitation and being upset and my inability to act immediately is that ‘we need to do this before the regulators say we can’t do it’.” The FDIC disfavors brokered deposits due to their volatility and the potential exposure they create for the FDIC. CW12 added that Fahey “knew that the regulators would never allow him to go after these brokered funds if he asked because it would put the FDIC at risk – so Fahey was walking a very fine line – he did not care what it would cost the Bank as to the rates it would need to pay on these brokered deposits.” CW12 further explained that Fahey’s request and actions were “a clear indication . . . that we scored very low on liquidity as we likely did on the other examination ratings. The examiners looked closely at our brokered deposits and liquidity

¹⁰ CW9 was hired by the Bank in 1996 and was a Senior Branch Administrator from mid-2007 through December 2008.

¹¹ CW12 worked at the Bank from 2001 to June 2009.

1 during the July 2008 examination. I was totally convinced in December 2008 as a result of this
2 meeting and the management changes that had been introduced in early December 2008 that
3 the bank was going to be C&D'ed [cease and desist] and that Fahey and Clementz who were
4 now running the bank knew it clearly.”

5 37. The Company's sudden reliance on brokered deposits was confirmed by CW12.
6 CW12 stated that, throughout the second half of 2008, “all of our correspondent banks were
7 turning down our fed funds lines of credit . . . Our lead bank, Key Bank turned us away in
8 November, as did Pacific Coast Bank and US Bank. There was no other way now for us to go
9 after funds other than brokered deposits. So all in all I would say that in December 2008 there
10 was a liquidity ‘panic’ at the top of the bank.” CW12 indicated that Defendant Fahey was
11 concerned about a “run on the bank” and the resulting need to meet withdrawal requests
12 because the Bank lacked liquidity and had a highly leveraged balance sheet.

13 38. A formal Report of Examination (“ROE”) by the FDI and FDIC was delivered
14 to Frontier on December 29, 2008. The Defendants did not publicly disclose the report or the
15 issues raised by the regulators at that time. Moreover, it is evident that Defendants knew of the
16 regulators' findings long before the formal ROE was delivered. Among other things, the ROE
17 stated that Frontier was “operating with a large volume of poor quality loans” and “with an
18 inadequate loan reserve.” Frontier later disclosed that it responded to these findings by
19 retaining “an independent consultant to review and evaluate the loan portfolio **in the Fall of**
20 **2008,**” i.e., before the ROE was delivered. (Emphasis added.) The ROE also indicated that
21 Frontier “was operating with management whose policies and practices [were] detrimental to
22 the Bank and jeopardize[d] the safety of its deposits.” Frontier later disclosed that, in response
23 to the regulators' concerns, the Company had engaged Fahey as Frontier's CEO and Chairman
24 and Michael J. Clementz as President on **December 4, 2008**, i.e., before the ROE was
25 delivered.

26 39. Subsequent events further confirm the severity of the problems that were known
27 to Defendants, but not disclosed to investors, during the Class Period. On or about September
28 30, 2009, the Bank filed a quarterly Consolidated Report of Condition and Income (referred to

1 as a “Call Report”) with the Financial Institutions Examination Council. The Call Report was
 2 updated on November 27, 2009. In response, the FDIC notified the Bank that it was
 3 “significantly undercapitalized” and required that it provide a Capital Restoration Plan. The
 4 FDIC rejected the plan submitted by the Bank. On January 11, 2010, the FDIC conducted a
 5 limited scope investigation, which again resulted in the FDIC informing the Bank that it was
 6 critically undercapitalized.

7 40. In the Spring of 2010, it was clear that Defendants’ were unable to restore the
 8 Bank to a safe and sound condition. Thus, on March 16, 2010, the FDIC issued a Prompt
 9 Corrective Action Directive to the Bank (attached hereto as Exhibit B), effectively seizing the
 10 Bank. However, despite their knowledge of the problems identified by the regulators since
 11 July or early August 2008, the first **public** disclosure of this information did not occur until
 12 March 24, 2009. On that date, the Bank issued a press release disclosing a Cease and Desist
 13 Order (attached hereto as Exhibit C). The Cease and Desist Order repeated the findings made
 14 in the ROE and ordered the Bank to immediately:

- 15 • Have and retain a qualified management team.
- 16 • Strengthen the Board of Director’s oversight including
 17 having the Board develop and implement a capital plan and
 18 a comprehensive policy for determining the adequacy of
 the allowance for loan and lease losses.
- 19 • Increase and maintain its capital levels.
- 20 • Reduce its risk exposure to assets classified as
 21 “substandard” or “doubtful.”
- 22 • Refrain from extending any additional credit to borrower’s
 23 whose loans have been charged-off or are classified as
 24 “loss” and are uncollected.
- 25 • Refrain from extending any additional credit to, or for the
 26 benefit of, any borrower who has a loan, or other extension
 of credit, classified in whole, or in part, as “doubtful” or
 27 “substandard” without collecting all past due interest.
- 28 • Revise and implement lending and collection policies.

- Revise its Concentration Policy which must limit and systematically reduce the number of commercial real estate and acquisition, development and construction loans.
- Develop and adopt an overhead and profitability plan.
- Revise and adopt a written liquidity and funds management policy and a liquidity and funds management policy to reduce the Bank's reliance on non-core funding sources.
- Refrain from paying dividends without prior written consent of the FDIC and DFI.
- Notify shareholders of the Consent Agreement.
- Provide quarterly progress reports to the FDIC and DFI.

41. By the end of March 2009, it became impossible for the Defendants to continue hiding their scheme. On March 31, 2009, Frontier's independent auditor issued a "going concern" qualification as to the Company's financial statements. The auditor also determined that Frontier had deficient internal control over its financial reporting, and expressed an adverse opinion thereon. The DFI closed the Bank on April 30, 2010 and the FDIC was appointed as the receiver. On May 6, 2010, UnionBanCal Corporation reported that its wholly-owned subsidiary, Union Bank, N.A., had entered into a purchase and assumption agreement with the FDIC pursuant to which Union Bank, N.A., acquired certain assets and assumed certain liabilities of the Bank. The value of the Bank's assets was reduced from \$2.79 billion to \$1.65 billion – an astounding 40% devaluation compared to what Frontier publicly reported during the Class Period.

42. Trading of Frontier stock was halted on May 12, 2010 and, two weeks later, the Nasdaq announced that it would be delisted. Frontier has told investors that the stock, which had traded for as much as \$186.00 per share during the Class Period, had become worthless.

DEFENDANTS' MATERIALLY FALSE AND MISLEADING STATEMENTS

43. Throughout the Class Period, Defendants made false and misleading statements to investors that failed to fully disclose the extent of the delinquent commercial real estate, construction, and land loans. In addition, the Defendants failed to adequately and timely

1 record losses for impaired loans, causing Frontier's financial results and its Tier 1 capital ratio
 2 to be materially misstated. The Defendants misled the market as to the true financial condition
 3 of Frontier and deprived investors of material information that was necessary to evaluate the
 4 Company.

5 **A. Second Quarter 2008**

6 44. The Class Period begins on July 22, 2008. On that date, Frontier issued a press
 7 release with the Company's preliminary financial results for the second quarter 2008, which
 8 ended March 31, 2008. The release included the following statements:

9 . . . For the three months ended June 30, 2008, net income totaled
 10 \$2.1 million, a decrease of \$16.1 million, or 88.6%, compared to
 11 net income of \$18.2 million for the three months ended June 30,
 12 2007. For the three months ended June 30, 2008, the provision for
 13 loan losses totaled \$24.5 million, compared to \$1.9 million for the
 14 three months ended June 30, 2007, an increase of \$22.6 million.
 On a diluted per share basis, second quarter 2008 net income was
 \$0.04 per share, compared to \$0.40 per share for the second quarter
 2007.

15 45. This statement was materially false and misleading at the time it was made. The
 16 joint FDIC/DFI investigation found that Frontier engaged in unsafe and unsound banking
 17 practices had inadequate reserves for loan losses. Had the Company accurately reserved for
 18 loan losses, net income and earnings per share would have been reduced.

19 46. Regarding Frontier's general financial condition, the release stated:

20 *Allowance for Loan Losses*

21 . . . "With total reserves for loans losses of \$81.6 million,
 22 including the reserve for undisbursed, and tangible capital of over
 23 \$380 million, we have over \$460 million to absorb any losses that
 24 may arise due to market uncertainties," said Rob Robinson, Chief
 Credit Officer of Frontier Bank.

25 *Credit Quality*

26 At June 30, 2008, nonperforming assets were 2.9% of total assets,
 27 compared to 0.97% at March 31, 2008, 0.53% at December 31,
 28 2007, and 0.31% at June 30, 2007. . . .

* * *

Capital

Management constantly monitors the level of capital, considering, among other things, our present and anticipated needs, current market conditions and other relevant factors, including regulatory requirements . . .

47. The foregoing statements were materially misleading when issued. The Defendants knew, or were reckless in not knowing, that Frontier was engaged in unsafe and unsound banking practices because the Bank was operating with: (1) an inadequate loan valuation reserve; (2) a large amount of poor quality loans; and (3) inadequate capital based on the kind and quality of assets held by the Bank.

48. The Company held its second quarter 2008 analyst conference call on July 22, 2008. The call was led by Defendants Dickson, Wheeler, and Robinson, as well as Lyle Ryan (President and Chief Banking Officer). Defendant Dickson stated that:

- “Our capital ratios remain strong”
- “With the challenging housing market we feel good about that [total loan loss reserve of \$81.6 million or 2.14% of total loans] loan loss reserve.”
- “As we indicated in the press release, our leverage, our capital ratios remain very strong with leverage ratio at 9.69%, out Tier 1 capital ratio at 9.96% and our total risk-based capital at 11.22%.”
- “. . . we feel very good about our capital and reserve position.”
- “So as we stand today, we have no intent on raising additional capital.”
- “I’d like to point out to the callers that we have a very experienced management team.”
- “. . . we have three ex-bankers that are on our Board of Directors. . . . Between those three we have over 150 years of bank experience to help guide us through these challenging times.”

- “When we decide that a write off is proved at this moment in time that’s generally because we are looking at saying that the probability of recovery on that is very low. If we chose to reserve and wait, it is because we believe that we have a good opportunity to recover a portion of that reserve, and maybe all of it.”

49. Robinson reinforced these representations by stating:

- “. . . we continue to take steps necessary to maintain a strong loan loss reserve.”
- “. . . we believe that our reserves are substantial and provide adequate support for any losses that may arise as we work closely with our lender and our customers get through these very challenging times.”
- “I think we are being pretty conservative when it comes to the specific category, which would be all non-accrual loans where you are doing a FAS 114 analysis. And in those cases, for the most part we are taking a 30% discount off the appraised value. So hopefully [we are] leaving ourselves plenty of leeway for further deterioration in the market.”

50. The statements made during the conference call were false and misleading at the time they were made. They misrepresented and omitted to state that during this fiscal quarter Frontier engaged in the following unsafe and unsound banking practices identified in the July 2008 ROE: (1) operating with inadequate capital in relation to the kind and quality of assets held by the Bank; (2) operating with an inadequate loan valuation reserve; (3) operating with a large volume of poor quality loans; and (4) operating with inadequate provisions for liquidity.

51. On August 1, 2008, Frontier filed a Form 10-Q stating the Company’s financial results for the second quarter of 2008. The Form 10-Q, signed by Defendants Dickson and Wheeler, stated: “In the opinion of management, the consolidated financial statements reflect all adjustments necessary for a fair presentation of the financial condition and results of operation for the interim periods presented.” It also stated that “[W]e have emphasized commercial real estate and construction and land development related lending. . . . While we

1 have significant balances within this lending category, we believe that our lending policies and
 2 underwriting standards are sufficient to minimize risk, despite slowing in the Puget Sound
 3 region real estate market that began in the third quarter of 2007.” The statement also addressed
 4 the capitalization of the bank. “It is our policy that capital be maintained above the point
 5 where, for regulatory purposes, it would continue to be classified as ‘well capitalized.’”

6 52. The representations set forth in the paragraph above were false and misleading
 7 at the time they were made. The Defendants knew, or recklessly disregarded, undisclosed
 8 information indicating that Frontier engaged in the unsafe and unsound banking practices set
 9 forth in the July 2008 ROE: (1) operating with inadequate capital in relation to the kind and
 10 quality of assets held by the Bank; (2) operating with an inadequate loan valuation reserve; (3)
 11 operating with a large volume of poor quality loans; and (4) operating with inadequate
 12 provisions for liquidity.

13 53. The 2Q 2008 Form 10-Q also included certifications signed by Defendants
 14 Dickson and Wheeler pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002
 15 (“Sarbanes-Oxley Certifications”). They verified, *inter alia*, that: (i) the filing did not contain
 16 any false or misleading statements or omissions; (ii) the financial statements accurately
 17 reflected the Company’s financial condition; and (iii) the Company had adequate disclosure
 18 and internal controls.

19 54. As Frontier’s Form 10-Q filed August 1, 2008 contained several false and
 20 misleading misstatements, Dickson’s and Wheeler’s certification were materially false when
 21 made.

22 55. On September 18, 2008, Frontier filed a Form 8-K with the SEC, which stated
 23 in part:

24 Item 2.06 Material Impairments.

25 Frontier and its subsidiary, Frontier Bank, anticipate that they will
 26 continue to exceed all capital levels necessary to remain “well
 27 capitalized” under regulatory guidelines at quarter-end.
 28

1 56. The foregoing statement was false when made. The ROE confirms that, at the
2 time this representation was made, Frontier was operating with inadequate capital in relation to
3 the kind and quality of assets held by the Bank.

4 **B. Third Quarter 2008**

5 57. On October 23, 2008, Frontier reported its third quarter 2008 financial results.
6 In a press release, the Company reported a net loss of \$17.8 million, or (\$0.38) per share. In
7 addition:

8 John J. Dickson, President and CEO of Frontier Financial
9 Corporation, said, "The uncertainties in the economy and the
10 housing market in the Pacific Northwest have created some
11 challenging times for Frontier Bank and our borrowers. Although
12 the economy in our area remains in better shape than other parts of
13 the country, **we continued to build our reserves for future loan**
14 **losses** based on this uncertainty, resulting in a total reserve
15 (including reserves for undisbursed loans) of \$109.5 million or
16 2.86% of total loans. **At the end of September, Frontier**
17 **remained well capitalized** for regulatory capital purposes and
18 **maintained strong liquidity.** In addition, we were pleased with
19 our strong growth in deposits and noninterest income." (Emphasis
20 added).

21 58. Frontier reassured investors that it was improving the quality of its loans and
22 maintaining its well capitalized status:

23 *Loans*

24 ... Lyle E. Ryan, President of Frontier Bank stated, "The
25 reduction in loan originations and loan growth in the third quarter
26 reflects our strategy of reducing our exposure to residential
27 construction and limit our loan growth in order to preserve capital.
28 We will continue to evaluate balance sheet strategies in the fourth
29 quarter in order to maintain our well capitalized status."

30 *Allowance for Loan Losses*

31 The total allowance for loan losses was \$106.6 million, or 2.78%,
32 of total loans outstanding at September 30, 2008, compared to
33 \$54.0 million, or 1.49%, at December 31, 2007, and \$45.1 million,
34 or 1.36%, at September 30, 2007. The allowance for loan losses,
35 including the reclassified allocation for undisbursed loans of \$2.8

million, would amount to a total allowance of \$109.5 million, or 2.86%, of total loans outstanding as of September 30, 2008. For the quarter ended September 30, 2008, net loan charge-offs were \$14.3 million, or 0.37%, of average quarterly loans. This compares to net loan charge-offs of \$594 thousand, or 0.02%, of average loans for the quarter ended December 31, 2007, and \$326 thousand, or 0.01%, of average loans for the quarter ended September 30, 2007.

Credit Quality

At September 30, 2008, nonperforming assets were 4.92% of total assets, compared to 2.97% at June 30, 2008, 0.53% at December 31, 2007, and 0.35% at September 30, 2007. Nonaccruing loans were \$205.2 million at September 30, 2008, up from \$119.9 million at June 30, 2008, \$20.9 million at December 31, 2007, and \$11.3 million at September 30, 2007.

* * *

Liquidity

. . . Management has the ability to access many sources of liquidity, such as the sale of available for sale securities, additional borrowings from the FHLB, and borrowings from the Federal Reserves Bank, wholesale deposits or additional borrowings at correspondent banks. . . .

59. The representations made regarding the third quarter 2008 results were materially false and misleading when made. The Defendants knew, or were reckless in not knowing, that Frontier engaged in unsafe and unsound banking practices identified in the July 2008 ROE, including but not limited to: (1) operating with inadequate capital in relation to the kind and quality of assets held by the Bank; (2) operating with a an adequate loan valuation reserve; and (3) operating with a large volume of poor quality loans; and (4) operating with inadequate provisions for liquidity. Moreover, the Bank was losing access to overnight credit from other banks, which required the Bank to start depending on brokered deposits.

60. In addition, the Company made false and misleading statements during the Company's third quarter 2008 analyst conference call held on October 23, 2008. The call was lead by Defendants Dickson, Wheeler, and Robinson. When addressing residential lot loan

1 non-performing assets, Robinson stated that “we’ve either written down these NPAs to current
2 market or have appropriately funded our reserve to cover these loans.” He also reassured
3 investors that “[o]n our allowance for loan losses, . . . , we continue to take steps necessary to
4 maintain a very strong and robust loan reserve.” He further stated, “we believe our reserve is
5 substantial and provides adequate support for losses that may arise as our management team
6 works through these challenging times.”

7 61. The above emphasized statements regarding the third quarter 2008 results were
8 materially false and misleading at the time they were made. The Defendants knew, or were
9 reckless in not knowing, that Frontier engaged in unsafe and unsound banking practices
10 identified in the July 2008 ROE, including but not limited to: (1) operating with inadequate
11 capital in relation to the kind and quality of assets held by the Bank; (2) operating with a an
12 adequate loan valuation reserve; and (3) operating with a large volume of poor quality loans.

13 62. Defendant Dickson stated that the Bank was “in the well-capitalized status for
14 regulatory capital purposes.” He also mentioned that: (1) Frontier recently “had a discussion
15 with the FDIC” related to Frontier’s leveraging strategy; (2) that they had completed their
16 recent regulatory exam that quarter; (3) that they were informed the day before that the FDIC
17 was not going to accept their internal leveraging strategy as regulatory capital”; (4) “we’re
18 looking and saying we do need capital”; and (5) “we are still well capitalized for regulatory
19 capital purposes and we are in a very good liquidity position.” These statements were made
20 without disclosing that the FDIC/DFI had concluded their examination of Frontier, had found
21 material deficiencies in its capital and loan loss reserves, and had determined to issue a Cease
22 and Desist Order against Frontier. By omitting this critical information, the Defendants misled
23 investors regarding the joint examination including that Frontier was operating with inadequate
24 capital in relation to the kind and quality of assets held by the Bank.

25 63. The foregoing statements from the Company’s third quarter 2008 conference
26 call also misrepresented the adequacy of capital in relation to the loans held as was confirmed
27 by the July ROE 2008, the subsequent March 2009 Cease and Desist Order and the March
28 2010 Supervisory Prompt Corrective Action Directive.

64. On August 1, 2008, Frontier filed a Form 10-Q with the Company's financial results for third quarter 2008. The Form 10-Q, signed by Defendants Dickson and Wheeler, stated that the financial statements included therein provided a "fair presentation" of the Company's financial condition. Among other things, the financial statements represented: "It is our policy that capital be maintained above the point where, for regulatory purposes, it would continue to be classified as 'well capitalized.' As of June 30, 2008, we are in compliance with that policy." It reiterated this point twice:

- "At September 20, 2008, we remain 'well capitalized' based on the ratios established under regulatory guidelines."
- "We remain 'well capitalized' at September 30, 2008, based on our financial statements prepared in accordance with generally accepted accounting principles and the general percentages in the regulatory guidelines."

65. The representation that Frontier was in compliance with their capitalization policy was misleading as it omitted the fact that the July 2008 ROE found that Frontier was operating with inadequate capital in relation to the kind and quality of assets held by the Bank.

66. The Form 10-Q also included Sarbanes-Oxley Certifications signed by Defendants Dickson and Wheeler. They verified, *inter alia*, that: (i) the filing did not contain any false or misleading statements or omissions; (ii) the financial statements accurately reflected the Company's financial condition; and (iii) the Company had adequate disclosure and internal controls. As Frontier's Form 10-Q filed August 1, 2008 contained several misstatements, Dickson's and Wheeler's certifications were materially false when made.

C. 2008 Year-End Results

67. On January 29, 2009, Frontier issued a press release announcing its financial results for the fourth quarter of 2008 and the fiscal year ended December 31, 2008. The release stated that, in Q4 2008, the Company had a net loss of \$89.5 million or (\$1.90) per share. For FY 2008, the Company reported a net loss of \$89.7 million or (\$1.91) per share. The press release further announced that:

1 . . . **Management continues to recognize loan quality**
 2 **deteriorating on a timely basis** and aggressively address work out
 strategies. . . .

3 Patrick M. Fahey, Chairmen and CEO of Frontier Financial
 4 Corporation said, "The Board of Directors, in responding to these
 5 challenging and unprecedented times, has taken a number of
 6 corrective actions. The leadership of the Corporation was
 7 restructured to enhance the effort to rebalance the Bank to a
 portfolio with a much smaller concentration in real estate lending
 and an increase in commercial and industrial business and
 8 consumer loans."

9 In the third quarter, we announced strategies to improve asset
 quality, preserve capital, reduce expenses and grow core deposits. .
 10 . . At December 31, 2008, nonperforming assets totaled \$446.0
 11 million, or 10.9% of total assets. This compares to nonperforming
 12 assets of \$208.9 million, or 4.9% of total assets, at September 30,
 2008, and \$21.3 million, or 0.53% of total assets, at December 31,
 2007.

13 * * *

14 **Capital**

15 Management constantly monitors the level of capital, considering,
 16 among other things, our present and anticipated needs, current
 17 market conditions and other relevant factors, which may
 18 necessitate changes in the level of capital. . . .

19 * * *

20 **Allowance for Loan Losses**

21 The total allowance for loan losses was \$112.6 million, or 2.98%,
 22 of total loans outstanding at December 31, 2008, compared to
 \$106.6 million, or 2.78%, at September 30, 2008, and \$54.0
 23 million, or 1.49%, at December 31, 2007. . . .

24 For the year ended December 31, 2008, the provision for loan
 25 losses increased \$108.6 million, to \$120.0 million, compared to
 \$11.4 million for the year ended December 31, 2007. Net charge-
 26 offs increased \$62.1 million, to \$63.0 million in 2008, compared to
 \$920 thousand in 2007.

27 Net charge-offs totaled \$39.2 million, or 1.02% of average
 28 quarterly loans, for the quarter ended December 31, 2008. This

1 compares to net charge-offs of \$14.3 million, or 0.37%, and \$594
 2 thousand, or 0.02%, for the quarters ended September 30, 2008,
 3 and December 31, 2007, respectively.

4 * * *

5 **Liquidity**

6 We continue to closely monitor and manage our liquidity position
 7 understanding that this is of critical importance in today's tight
 8 market. . . . Management has the ability to access additional
 9 sources of liquidity, such as the sale of available for sale securities
 10 and additional borrowings from the FHLB. . . . (Emphasis added.)

11 68. These statements were false and misleading because the ROE found that
 12 Frontier was engaged in the following unsafe and unsound banking practices identified in the
 13 ROE: (1) operating with inadequate capital in relation to the kind and quality of assets held by
 14 the Bank; (2) operating with an inadequate loan valuation reserve; (3) operating with a large
 15 volume of poor quality loans; and (4) operating with inadequate provisions for liquidity.

16 69. In addition, several false and misleading statements were made during the
 17 Company's analyst call on January 29, 2009. The call was led by Defendants Dickson,
 18 Wheeler, and Robinson. Defendant Dickson stated: "Another positive . . . Our reserve for loan
 19 losses exceeds 3% of total loans. Our liquidity exceeded 28% at the end of the year, and **that's**
 20 **a strong liquidity ratio . . .**" Robinson further represented that Frontier's "current reserves . . .
 21 are appropriate" and that "we believe our reserve is substantial and provides adequate
 22 support for losses that may arise"

23 70. During the conference call an analyst asked, "what is the capital range that
 24 would make you more comfortable, given what you're seeing in the portfolio?" Defendant
 25 Fahey responded that, "with what we're looking at right now, we think it's a reasonable level;
 26 none of the folks that we've talked to disagree." With regard to the Company's capital needs,
 27 another analyst specifically asked: "What are the regulators telling you to do? What's plan B?"
 28 Fahey responded:

1 I'm not going to put out a figure but I will tell you we don't think
 2 we need that much in equity. The regulators, I think I have had
 3 over my career, an excellent relationship with the regulators.
 4 We're communicating with them; they're communicating with us.
 5 **I can't tell you what there actions are going to be.** They are
 6 obviously very skittish as everybody is about what is going on in
 7 banking. I can tell you that, given what we now know, while I
 8 can't assure you that we would not on an ongoing basis without
 9 capital, drop below well capitalized and possibly into the
 10 adequately capitalized, which a number of banks have. What I can
 11 say from what **we know is that we can resolve this problem and**
 12 **continue to move forward . . .**

13 . . . I can tell you that **we are not ignoring the regulators.** We are
 14 in communication with them and I will say that my impression, I
 15 can't speak for them, is **they have appreciated if not applauded**
 16 **the steps that the company has taken thus far and they**
 17 **understand our plan and I haven't heard anything negative**
 18 **from them about it. . .** (Emphasis added.)

19 71. The statements were false and misleading because the July 2008 ROE found
 20 that Frontier was (1) operating with inadequate capital in relation to the kind and quality of
 21 assets held by the bank; and (2) operating with an inadequate loan reserve. Moreover, on
 22 December 29, 2008, Frontier received a copy of the final ROE as of June 30, 2008.

23 72. On March 12, 2009, Frontier filed its Annual Report on Form 10-K for fiscal
 24 year 2008. The Form 10-K, signed by Defendants Wheeler and Fahey, stated that:

- 25 • "We are regularly reviewed or audited by the Federal
 26 Reserve, the Federal Deposit Insurance Corporation
 27 ("FDIC") and the Washington Department of Financial
 28 Institutions, Division of Banks ("DFT") during which
 examinations such agencies assess our compliance with
 applicable law and regulations."
- "We believe that our loan portfolio has been subject to
 rigorous examination by banking regulators and our own
 credit review function that we are taking appropriate
 precautions to address the risks associated with our
 concentration in commercial real estate lending."
- "As of December 31, 2008, management believe[d] that we
 have sufficient capital resources and liquidity to be able to
 continue our normal business operations."

73. Additionally, the Form 10-K stated that Frontier had adequate disclosure controls and procedures:

Management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2008. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer each concluded that as of December 31, 2008, **we maintained effective disclosure controls and procedures** in all material respects, including those to ensure that information required to be disclosed in reports filed or submitted with the SEC is . . . accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate **to allow for timely decisions regarding required disclosure.** (Emphasis added.)

74. These statements were materially misleading as they omitted the fact that, no later than August 8, 2008, the DFI and FDIC had informed the Board of Directors and senior management of significant problems that required disclosure to investors. Frontier's failure to make timely disclosures to investors shows that the Company lacked effective disclosure controls and procedures.

75. The Form 10-K included Sarbanes-Oxley Certifications signed by Defendants Dickson and Wheeler. They verified, *inter alia*, that: (i) the filing did not contain any false or misleading statements or omissions; (ii) the financial statements accurately reflected the Company's financial condition; and (iii) the Company had adequate disclosure and internal controls. As the 2008 Form 10-K contained several misstatements, Dickson's and Wheeler's certifications were materially false when made.

DEFENDANTS' FAILURE TO COMPLY WITH GAAP AND SEC RULES

76. To inflate the price of Frontier's stock, Defendants caused the Company to falsely report its results for fiscal second quarter of 2008 through fiscal year end of 2008 by failing to properly account for its loan losses reserves, which overstated the Company's assets and net income. Specifically, Defendants failed to reserve for Frontier's risky and impaired construction and land loans. Defendants failed to increase Frontier's ALLL and intentionally

1 manipulated Frontier's loan loss provision to inflate earnings. Had defendants properly
2 increased Frontier's reserves for credit and loan losses as GAAP and SEC rules required,
3 Frontier would have been required to drastically reduce its net income and earnings per share.
4 The failure to take adequate credit and loan loss reserves inflated Frontier's financial condition,
5 and its capital position, each quarter.

6 77. Frontier's Class Period financial results were included in a Form 10-K and
7 Form 10-Qs, as well as news releases disseminated to the public, as described above.
8 Defendants' SEC filings represented that the financial information presented therein was a fair
9 statement of Frontier's financial results and that the results were prepared in accordance with
10 GAAP when, in fact, they were not.

11 78. GAAP are those principles recognized by the accounting profession as the
12 conventions, rules and procedures necessary to define accepted accounting practices at a
13 particular time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial
14 statements filed with the SEC which are not prepared in compliance with GAAP are presumed
15 to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires
16 that interim financial statements, such as quarterly financial statements, must also comply with
17 GAAP, with the exception that interim financial statements need not include disclosures which
18 would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R.
19 §210.10-01(a).

20 79. Defendants' representations were false and misleading as to the financial
21 information reported, as such financial information was not prepared in conformity with
22 GAAP, nor was the financial information a "fair representation" of Frontier's financial
23 condition and operations, causing the financial results to be presented in violation of GAAP
24 and SEC rules.

25 80. The two central accounting items related to defendants' fraudulent manipulation
26 of Frontier's loan loss reserves during the Class Period were ALLL on the balance sheet
27 (which reduces assets), and the corresponding loan loss provision, which is a direct reduction
28 of pretax earnings on Frontier's income statement. The accounting for these items is governed

1 by specific GAAP provisions and SEC rules. Because there is a plethora of guidance on the
2 subject, defendants were well informed of how to account for the ALLL and loan loss
3 provision during the Class Period. The rules that defendants violated are set forth below.

4 81. Section 9.19 of the Audit and Accounting Guide for Depository and Lending
5 Institutions provides that financial institutions are responsible for “[m]aintain[ing] adequate
6 controls to ensure that ALLL is consistently determined in accordance with GAAP, stated
7 policies and procedures, and relevant supervisory guidance.”

8 82. Section 9.04 of the same Accounting Guide for Depository and Lending
9 Institutions also provides: “Management is responsible for estimating credit losses. . . .
10 management must make careful judgments about collectability and estimates of losses.
11 Management’s judgments often depend on micro- and macro-economic factors; past, current,
12 and anticipated events based on facts in evidence at the balance-sheet date; and realistic
13 courses of action it expects to take.”

14 83. Under GAAP, a loss contingency is an existing condition, situation, or set of
15 circumstances involving uncertainty as to possible loss. *See* Statement of Financial
16 Accounting Standards (“SFAS”) No. 5, ¶1, *Accounting for Contingencies*. The collectability
17 of construction and land loans is an example of a loss contingency. GAAP requires that an
18 estimated loss from a loss contingency be accrued by a charge to income if both of the
19 following conditions are met: “(a) [i]nformation available prior to issuance of the financial
20 statements indicates that it is probable that an asset had been impaired or a liability had been
21 incurred at the date of the financial statements[; and] (b) [t]he amount of loss can be reasonably
22 estimated.” *See* SFAS No. 5, ¶8.

23 84. Even if no accrual is made for a loss contingency because one or both of the
24 above conditions of SFAS No. 5 are not met, or if an exposure to loss exists in excess of the
25 amount accrued, Defendants were still required to disclose the contingency when there is at
26
27
28

1 least a “reasonable possibility” that a loss or an additional loss may have been incurred.¹²
 2 SFAS No. 5, ¶10. The disclosure shall indicate the nature of the contingency and shall give an
 3 estimate of the possible loss or range of loss or state that such an estimate cannot be made. *See*
 4 SFAS No. 5, ¶10.

5 85. In assessing the collectability of a loan, a company will either evaluate the loan
 6 on a separate basis under SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, or
 7 will group the loan together into a risk pool with other loans having similar characteristics
 8 under SFAS No. 5. While SFAS No. 5 provides the basic guidance for recognition of
 9 impairment losses for all contingencies, SFAS No. 114 provides guidance on measurement and
 10 disclosure for loans that are individually identified for evaluation and deemed to be impaired.
 11 A company will establish a Specific Valuation Allowance (“SVA”) for impairments losses
 12 related to specific loans and will establish a General Valuation Allowance (“GVA”) for losses
 13 related to a pool of loans.

14 86. Furthermore, the SEC provides explicit guidance on the proper accounting for
 15 loan losses that defendants were required to follow, but did not. Staff Accounting Bulletin
 16 (“SAB”) No. 102 states in pertinent part:

17 It is critical that loan loss allowance methodologies incorporate
 18 management’s current judgments about the credit quality of the
 19 loan portfolio through a **disciplined and** consistently applied
 20 process. . . . A registrant’s loan loss allowance methodology
 21 generally should . . . [c]onsider all known relevant internal and
 22 external factors that may affect loan collectibility [and] [b]e based
 23 on current and reliable data[.]

22 87. SAB No. 102 also provides:

23 Factors that should be considered in developing loss measurements
 24 includ[ing] . . . [l]evels of and trends in delinquencies and impaired
 25 loans [and] [e]ffects of any changes in risk selection and
 26 underwriting standards, and other changes in lending policies,
 27 procedures, and practices [.]

27 ¹² GAAP defines “reasonably possible” as “[t]he chance of the future event or events occurring
 28 is more than remote but less than likely.” SFAS No. 5, ¶3.

1
2 88. SAB No. 102 further states that:

3 For many entities engaged in lending activities, the allowance and
4 provision for loan losses are significant elements of the financial
5 statements. Therefore, the staff believes it is appropriate for an
6 entity's management to review, on a periodic basis, its
7 methodology for determining its allowance for loan losses.

8 89. In violation of GAAP and SEC rules, defendants failed to reserve for Frontier's
9 risky and impaired commercial real estate term loans, and construction and land development
10 loans, causing its assets and net income to be overstated. Frontier's collapse was due in
11 significant part to problems with Frontier's construction and land loans, which required large
12 write-offs in impaired loans and dramatic increases in the Company's provision for loan losses.

13 90. Frontier's concentration in construction and land loans carried additional risks
14 due to the nature of the types of loans. Construction lending is inherently more risky than
15 financing finished buildings with established tenants. If a residential construction project
16 cannot be completed, the value of the project would be significantly less than the appraised
17 value due to a lack of proper infrastructure or ongoing support.

18 91. A bank is required by FDIC regulations to maintain adequate capital levels to
19 ensure the bank can absorb a reasonable amount of losses, to promote public confidence and to
20 protect depositors. In determining if a bank's level of capital is adequate, it must not only meet
21 regulatory requirements, but it must also be commensurate with the bank's risk profile.
22 Regulatory capital requirements set minimum standards for banks, which are designed for
23 banks that do not present credit or other risks requiring additional capital. A bank's
24 compliance with the minimum standards does not automatically ensure the bank has
25 maintained an adequate level of capital. Banks that engage in higher-risk activities require
26 capital well in excess of the minimum requirements, especially if the higher-risk activities are
27 conducted at significant concentration levels.

28 92. Defendants caused Frontier to maintain inadequate capital levels in violation of
FDIC regulations. As discussed above, defendants manipulated the Company's loan loss

1 reserves, causing Frontier to understate its ALLL. The failure to take adequate credit and loan
2 loss reserves inflated Frontier's financial position, including its capital position.

3 93. In addition, defendants failed to maintain a proper level of capital that was
4 commensurate with its risk profile. During the Class Period, Frontier reportedly maintained
5 capital levels above the minimum 10% level required by the FDIC for a bank to be categorized
6 as well-capitalized. Nonetheless, defendants failed to maintain capital levels suitable to the
7 Bank's high-risk loan portfolios.

8 94. During the Class Period, defendants violated GAAP and SEC rules by
9 intentionally manipulating the Company's reserves and provision for loan losses to conceal
10 loan impairment and by willfully disregarding known adverse facts and red flags. Despite
11 having concentrations in high-risk loans, defendants failed to properly account for Frontier's
12 risky and impaired construction and land loans. The failure to take adequate credit and loan
13 loss reserves overstated the Company's assets and net income and ultimately led to the collapse
14 of Frontier.

15 95. Despite red flags indicating by late 2006 and early 2007 that the real estate
16 market was softening, Frontier only belatedly increased its loan loss reserves in mid-2008, and
17 then did so inadequately.

18 96. The financial statements certified by defendants during the Class Period as
19 alleged above were not in accordance with GAAP and SEC rules. Section 302 of the
20 Sarbanes-Oxley Act of 2002 and SEC Rules 13a-14(a) and 15d-14(a) of the Exchange Act
21 required defendants Dickson, Fahey, and Wheeler to certify to the SEC and investors the
22 fairness of the financial information in each quarterly and annual report. Defendants were
23 required to, and did, certify that the financial statements and other financial information
24 included in the reports were fairly presented in all material respects. Defendants also stated
25 that the reports did not contain any untrue statement of material fact or omit to state a material
26 fact. In addition, defendants stated that Frontier had established and maintained disclosure
27 controls and procedures sufficient to ensure that the financial and non-financial information
28

1 required to be disclosed in SEC reports was recorded, processed, summarized and reported
2 within the specified time periods.

3 97. Defendants knowingly certified misleading and inaccurate financial statements
4 that were not in accordance with GAAP and SEC rules. In accordance with §906 of the
5 Sarbanes-Oxley Act of 2002 and 18 U.S.C. §1350, defendants were required to certify each
6 periodic report that includes financial statements. Their signed certifications falsely stated
7 that: (i) the report fully complied with the requirements of §13(a) or §15(d) of the Exchange
8 Act; and (ii) the information contained in the report fairly presented, in all material respects,
9 the financial condition and results of operations of Frontier.

10 98. On the dates alleged above, defendants signed and filed with the SEC
11 certifications under SEC Rules 13a-14(a)/15d-14(a) of the Exchange Act and §906 of the
12 Sarbanes-Oxley Act of 2002 attesting to the accuracy and truthfulness of the corresponding
13 Forms 10-K and 10-Q for Frontier. At the time defendants signed these certifications, they
14 knew or recklessly disregarded that they were false for the reasons alleged herein.

15 99. The defendants caused Frontier to fail to disclose known trends and
16 uncertainties related to its construction and land loans in violation of SEC regulations.
17 Defendants caused Frontier to provide misleading disclosures concerning its lending and credit
18 risk practices and the quality of Frontier's loan portfolios. Defendants further downplayed the
19 risks surrounding the Company's real-estate related assets by misrepresenting the risk
20 management practices in place at Frontier and by downplaying the overall impact the housing
21 and credit crisis was having on Frontier's business. Defendants further caused Frontier to fail
22 to disclose known trends and uncertainties related to its capital adequacy.

23 100. Under SEC Regulations, Item 7 of Form 10-K and Item 2 of Form 10-Q,
24 MD&A requires the issuer to furnish information required by Item 303 of Regulation S-K (17
25 C.F.R. §229.303). In discussing results of operations, Item 303 of Regulation S-K requires the
26 registrant to:

1 Describe any known trends or uncertainties that have had or that
2 the registrant reasonably expects will have a material favorable or
3 unfavorable impact on net sales or revenues or income from
continuing operations.

4 The instructions to paragraph 303(a) further state:

5 The discussion and analysis shall focus specifically on material
6 events and uncertainties known to management that would cause
7 reported financial information not to be necessarily indicative of
future operating results

8
9 101. In addition, in its May 18, 1989 Interpretive Release No. 34 26831, the SEC has
10 indicated that registrants should employ the following two-step analysis in determining when a
11 known trend or uncertainty is required to be included in the MD&A disclosure pursuant to
12 Item 303 of Regulation S-K:

13 A disclosure duty exists where a trend, demand, commitment,
14 event or uncertainty is both presently known to management and
15 reasonably likely to have material effects on the registrant's
financial condition or results of operation.

16 102. The MD&A requirements are intended to provide, in one section of a filing,
17 material historical and prospective textual disclosure enabling investors and other users to
18 assess the financial condition and results of operations of the registrant, with particular
19 emphasis on the registrant's prospects for the future. As Concept Release on MD&A,
20 Securities Act of 1933, Release No. 33-6711, 1987 SEC LEXIS 2001, at *6-*7 (Apr. 21,
21 1987), states:

22 The Commission has long recognized the need for a narrative
23 explanation of the financial statements, because a numerical
24 presentation and brief accompanying footnotes alone may be
25 insufficient for an investor to judge the quality of earnings and the
26 likelihood that past performance is indicative of future
27 performance. MD&A is intended to give the investor an
opportunity to look at the company through the eyes of
management by providing both a short and long-term analysis of
the business of the company.

Section 229.303 (Item 303) MD&A states:

To the extent that the financial statements disclose material increases in net sales or revenues, provide a narrative discussion of the extent to which such increases are attributable to increases in prices or to increases in the volume or amount of goods or services being sold or to the introduction of new products or services.

And the instructions to paragraph 303(a) further state:

Where the consolidated financial statements reveal material changes from year to year in one or more line items, the causes for the changes shall be described to the extent necessary to an understanding of the registrant's businesses as a whole

103. According to MD&A, Securities Act Release No. 6349 (Sept. 28, 1981):

It is the responsibility of management to identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company.

104. Nonetheless, in violation of both GAAP and SEC rules, Frontier's fiscal second quarter 2008 through year end 2008 Forms 10-K and 10-Q reports failed to disclose known trends and uncertainties related to Frontier's operations. Defendants caused Frontier to misrepresent Frontier's risk management practices and the adequacy of the Company's capital and further caused Frontier to minimize the Company's risk exposure associated with its high-risk loan portfolios. Even when Frontier began to acknowledge certain risks, defendants continued to downplay them.

105. Frontier failed to disclose known trends and uncertainties in violation of SEC regulations by not providing full and adequate disclosures. Frontier's failure provided investors with a false and misleading depiction of the Company's operations.

106. Throughout the Class Period, defendants were able to cause the Company to issue materially false and misleading financial statements by means of circumventing and failing to establish and maintain adequate internal accounting controls over financial reporting

1 relating to its accounting for its loan loss reserves. Section 13(b)(2) of the Exchange Act
2 states, in pertinent part, that every reporting company must:

3 (A) make and keep books, records, and accounts, which, in
4 reasonable detail, accurately and fairly reflect the transactions and
dispositions of the assets of the issuer;

5 (B) devise and maintain a system of internal accounting controls
6 sufficient to provide reasonable assurances that –

7 * * *

8 (ii) transactions are recorded as necessary . . . to permit
9 preparation of financial statements in conformity with [GAAP].

10 15 U.S.C. §78m(b)(2)(A)-(B).
11

12 107. These provisions require an issuer to employ and supervise reliable personnel,
13 to maintain reasonable assurances that transactions are executed as authorized, to properly
14 record transactions on an issuer's books and, at reasonable intervals, to compare accounting
15 records with physical assets.

16 108. Defendants caused Frontier to violate §13(b)(2)(A) of the Exchange Act by
17 failing to maintain accurate records concerning its accounting for loan loss reserves. Frontier's
18 inaccurate and false records were not isolated or unique instances because they were
19 improperly maintained for multiple reporting periods. Accordingly, Frontier violated
20 §13(b)(2)(A) of the Exchange Act.

21 109. In addition, defendants caused Frontier to violate §13(b)(2)(B) of the Exchange
22 Act by failing to implement procedures reasonably designed to prevent accounting
23 irregularities. Defendants failed to ensure that proper review and checks were in place to
24 ensure that Frontier was recording and properly reporting its loan loss reserves. In fact, despite
25 knowing the true state of the Company's lack of adequate controls, defendants regularly issued
26 quarterly financial statements throughout the Class Period without ever disclosing the
27 deficiencies in Frontier's internal accounting controls and falsely asserted that its financial
28 statements complied with GAAP.

1 110. During the Class Period, defendants caused the Company to make
2 representations that Frontier's internal disclosure and accounting controls were designed to be
3 effective and detect and prevent fraud and had been tested and found to be effective.

4 111. These representations were false, as Frontier's disclosure controls and
5 procedures were not effective and the Company's financial statements were not fairly
6 presented in accordance with GAAP. During the Class Period, Frontier violated §13(b)(2)(A)
7 of the Exchange Act by failing to maintain adequate internal controls in order to ensure that its
8 financial statements were prepared in conformity with GAAP and that its public filings were
9 accurate.

10 112. Frontier's lack of adequate internal controls rendered the Company's Class
11 Period financial reporting inherently unreliable and precluded the Company from preparing
12 financial statements that complied with GAAP. Nonetheless, throughout the Class Period, the
13 Company regularly issued quarterly and annual financial statements without ever disclosing
14 the existence of the significant and material deficiencies in its internal accounting controls and
15 defendants falsely asserted that Frontier's financial statements complied with GAAP.

16 **LOSS CAUSATION/ECONOMIC LOSS**

17 113. Defendants' wrongful conduct, as alleged herein, directly and proximately
18 caused the economic loss suffered by Lead Plaintiff and the Class. Throughout the Class
19 Period, the market price of Frontier stock was inflated by Defendants' false and misleading
20 statements and omissions of material facts. As a result, Lead Plaintiff and the Class purchased
21 Frontier securities at artificially inflated prices. When the truth was revealed, the price of
22 Frontier's securities declined in response to remove the artificial inflation, thereby causing
23 substantial damage to Lead Plaintiff and the Class.

24 114. Frontier had the equivalent of 47,000,000 shares of stock outstanding during the
25 Class Period, which traded as high as \$186.00 per share. On March 24, 2009, Frontier
26 announced that it had signed the Cease and Desist Order. On March 23, 2009, prior to the
27 announcement, the stock closed at \$14.90 per share. In response to the disclosure, the price of
28

1 Frontier stock declined in a statistically significant amount, net of market and industry factors,
2 dropping to a closing price of \$11.80 on March 25, 2009.

3 115. The nearly 94% loss in value during the eight month Class Period was a direct
4 consequence of the Defendants' wrongdoing. It was foreseeable to Defendants that concealing
5 the true extent of the Company's financial difficulties would artificially inflate the stock price.
6 It was also foreseeable to Defendants that revelation of their misconduct, by way of the
7 Company's worsening financial condition, would cause a significant drop in Frontier's stock
8 price as the inflation was corrected. Accordingly, the conduct of the Company and the
9 Individual Defendants proximately caused foreseeable damages to Lead Plaintiff and the Class.

10 **BASIS FOR ALLEGATIONS**

11 116. Lead Plaintiff has made the foregoing allegations based on personal knowledge
12 as to his own acts and upon information and belief as to all other matters. Such information
13 and belief is based on the investigation undertaken by his counsel, which included, inter alia:
14 interviews with numerous former employees of Frontier and other persons with knowledge of
15 the events alleged herein; expert analysis; review of relevant filings made by Frontier with the
16 Securities and Exchange Commission; review of guidance issued by the federal and State of
17 Washington banking regulatory authorities; examination of GAAP; review of Frontier's and
18 other relevant websites; review of Frontier's press releases; review of Orders and other
19 information regarding Frontier available from the FDIC, DFI, and Federal Reserve Bank;
20 review of reports issued by securities analysts regarding Frontier; review of transcripts of
21 analyst conference calls held by Frontier; and review of news articles regarding Frontier.

22 **COUNT I**

23 **For Violations of §10(b) of the 1934 Act and SEC Rule 10b-5** 24 **Against All Defendants**

25 117. Lead Plaintiff incorporates all of the foregoing paragraphs by reference.

26 118. During the Class Period, defendants disseminated or approved the false
27 statements specified above, which they knew or recklessly disregarded were misleading in that
28 they contained misrepresentations and failed to disclose material facts necessary in order to

1 make the statements made, in light of the circumstances under which they were made, not
2 misleading.

3 119. Defendants violated §10(b) of the 1934 Act and Rule 10b-5 in that they:

4 (a) employed devices, schemes, and artifices to defraud;

5 (b) made untrue statements of material facts or omitted to state material
6 facts necessary in order to make the statements made, in light of the circumstances under
7 which they were made, not misleading; or

8 (c) engaged in acts, practices and a course of business that operated as a
9 fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of
10 Frontier common stock during the Class Period.

11 120. Lead Plaintiff and the Class have suffered damages in that, in reliance on the
12 integrity of the market, they paid artificially inflated prices for Frontier common stock. Lead
13 Plaintiff and the Class would not have purchased Frontier common stock at the prices they
14 paid, or at all, if they had been aware that the market price had been artificially and falsely
15 inflated by defendants' misleading statements.

16 **COUNT II**

17 **For Violation of §20(a) of the 1934 Act**
18 **Against Frontier and the Individual Defendants**

19 121. Lead Plaintiff incorporates all of the foregoing paragraphs by reference.

20 122. Defendants Dickson, Fahey, Clementz, and Wheeler acted as controlling
21 persons of Frontier within the meaning of §20(a) of the 1934 Act. By reason of their positions
22 with the Company, and their ownership of Frontier stock, these defendants had the power and
23 authority to cause Frontier to engage in the wrongful conduct complained of herein. Frontier
24 controlled each of the individual named defendants and all of its employees. By reason of such
25 conduct, defendants are liable pursuant to §20(a) of the 1934 Act.

PRAYER FOR RELIEF

WHEREFORE, Lead Plaintiff prays for judgment as follows:

- A. Declaring this action to be a proper class action pursuant to Fed.R.Civ.P. 23;
- B. Awarding Lead Plaintiff and the members of the Class damages, including interest;
- C. Awarding Lead Plaintiff reasonable costs and attorneys' fees; and
- D. Awarding such equitable/injunctive or other relief as the Court may deem just and proper.

JURY DEMAND

Lead Plaintiff demands a trial by jury.

Dated: October 15, 2010

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 15, 2010, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the following:

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